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No. 83-897

In the Supreme Court of the United States

OCTOBER TERM, 1983

LOURDES BLANCO STONEHILL AND PACITA C. BROOKS,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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Petitioners challenge the determination that their interests in certain property are subject to federal tax liens arising from their husbands' unpaid taxes. The sole question is whether the courts below properly interpreted the community property law of the Republic of the Philippines. The decision below is correct. Petitioners do not allege (nor is there) a conflict among the circuits on the question presented. There is no basis for review by this Court.

1. Petitioners are citizens and residents of the Philippines. They are married respectively to Harry S. Stonehill and Robert P. Brooks (hereinafter referred to as the husbands), who were U.S. citizens and Philippine residents during the tax years at issue. In 1965, the IRS, fearing that collection of the husbands' 1958-1961 federal income taxes

would be "jeopardized by delay," issued jeopardy assessments against them[1] under Section 6861(a) of the Code.[2] The filing of the jeopardy assessments created tax liens on the husbands' property. I.R.C. § 6321. The government instituted this action to foreclose those liens on certain real property owned by petitioners and their husbands in the United States (Pet. App. 6). After lengthy pre-trial proceedings, the government conceded that, under Philippine community property law, one-half of the husbands' 1958-1961 income was properly deemed to have been earned by petitioners (*id.* at 7). Since petitioners were not subject to U.S. tax, the assessments against the husbands were accordingly reduced (*ibid.*). The government contended, however, that all property acquired by petitioners and their husbands during marriage, including all of the property involved here, was available to discharge the husbands' tax liabilities (*id.* at 20). The parties agreed that the nature and extent of the husbands' interests in the conjugal property were governed by Philippine law (*ibid.*).

Both the district court (Pet. App. 72-74) and the court of appeals (*id.* at 20-25) accepted the government's contention, holding that, under Philippine community property law, assets acquired with conjugal funds during marriage are chargeable with all debts and obligations (including tax obligations) incurred by the husband in an effort to benefit the conjugal partnership. The courts reasoned that petitioners undeniably benefited from their husbands' business

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[1]The husbands have filed petitions for a writ of certiorari challenging the decision below insofar as it upholds the validity of the assessments. *Stonehill* v. *United States*, petition for cert. pending, No. 83-908; *Brooks* v. *United States*, petition for cert. pending, No. 83-909.

[2]Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended ("the Code" or "I.R.C.").

income, that the U.S. taxes were a cost of producing that income, and that the husbands' U.S. tax liabilities were accordingly dischargeable out of any community property the income was used to acquire (*id.* at 21-22, 73-74).

2. The decision below is correct. Under Philippine law, a married person's income during marriage is administered under a "conjugal partnership of gains" unless the parties otherwise agree in writing. See Phil. Civ. Code Ann. tit. VI (Paras 7th ed. 1971). Among the debts and obligations chargeable to the community property are those associated with activities undertaken to increase the conjugal estate. See *id.* at art. 161, at 493. As a rule, therefore, business debts, money judgments arising from business transactions, and taxes on property whose income redounds to the community's benefit, are all conjugal obligations. See *Suarez* v. *Alfiz*, Nos. 44292 and 44294-R (C.A.-G.R. Aug. 30, 1974); *Gonzales* v. *Cuevas*, 73 O.G. 6155, 6165-6166 (1977); Phil. Civ. Code tit. VI, art. 161, at 414 (Tolentino 4th ed. 1974).[3] As the courts below found (Pet. App. 21, 74), it is clear in this case that petitioners' husbands undertook the business activities that produced their 1958-1961 income in order to benefit the conjugal partnerships, that the conjugal partnerships did in fact benefit, and that the property upon which the IRS levied was community property acquired during marriage. The court of appeals thus correctly interpreted Philippine law to render that property subject to levy in satisfaction of the husbands' tax obligations.

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[3]By contrast, obligations arising out of activities that could not augment the conjugal estate, such as standing surety without a fee, or liabilities arising out of business ventures entered into after the spouses have separated, are not considered conjugal obligations. See *Perez* v. *Sheriff of Pasay City*, 64 O.G. 818, 819 (1968); *Laperal* v. *Katigbak*, 104 Phil. 999, 1004 (1958). See also *Luzon Surety Co.* v. *De Garcia*, 30 S.C.R.A. 111 (Phil. 1969).

There is no merit to petitioners' contention (Pet. 16) that they had a "vested" interest in their half of the conjugal assets so as to make that portion of the community property immune from IRS levy. It is a fundamental principle of Philippine community property law that neither spouse has a vested interest in any conjugal property while the marriage subsists. Upon dissolution of the marriage (whether by death, annulment or judicial decree) and upon payment of all marital debts, each spouse acquires a vested interest in half the net estate. Art. 142, at 447 (Paras 7th ed. 1971). See *Gibbs* v. *Government*, 59 Phil. 293 (1933); cf. *Commissioner* v. *Cadwallader*, 127 F.2d 547 (9th Cir. 1942). Until the happening of these events, however, each spouse's interest in the conjugal property remains indefinite and inchoate, and is "limited to one-half of the *net remainder* of the estate after the dissolution and liquidation of the partnership." Art. 143, at 368 (Tolentino 4th ed. 1974) (emphasis in original; footnote omitted). There is thus no basis for contending that any portion of the property involved here is immune from tax claims against petitioners' husbands. Cf. *Babb* v. *Schmidt*, 496 F.2d 957 (9th Cir. 1974).[4]

Finally, there is no basis for petitioners' contention (Pet. 11) that the decision below sanctions "unconstitutional * * * extra-territorial taxation." The IRS is attempting neither to tax petitioners nor to levy on property situated outside the United States. The effect of the decision below,

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[4]As petitioners note, the government conceded below (Pet. 7) and the court of appeals held (Pet. App. 20) that petitioners under Philippine law had "an immediate vested half interest" in the community income at the time it was earned, so that their share of the income was immune from U.S. tax. But this does not mean, as petitioners suggest (Pet. 16), that they thereby acquired "an immediate vested half interest" in the property purchased with the community income, so as to immunize that property from levy in satisfaction of tax liabilities incurred by their husbands. Indeed, as explained in the text, Philippine law is precisely to the contrary.

rather, is merely to prevent petitioners from insulating property located within the United States from an obligation imposed on it consistently with Philippine law, viz., the U.S. tax on their husbands' half of the community income. The fact that petitioners "do not owe fealty * * * to the United States" (Pet. 17) is fully recognized by exempting their half of the community income from tax in this country. But to say that petitioners' income cannot be taxed is not to say that conjugal property cannot be used to satisfy their husbands' tax debts. The decision below does not permit the IRS "in effect [to] tax[] indirectly what the Federal Government cannot tax directly" (Pet. 9-10), nor does it license "extra-territorial taxation" (*id.* at 10) in violation of the Fifth Amendment.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
Solicitor General

FEBRUARY 1984

DOJ-1984-02